

DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 01-0350

**Income Tax
For Tax Years 1995-98**

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ISSUE

I. Gross Income Tax—Partner's Distributive Share

Authority: 45 IAC 1.1-1-5; 45 IAC 1.1-2-13; IRC 704

Taxpayer protests removal of deductions from its partnership distributive share of gross income.

II. Tax Administration—Negligence Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests imposition of a ten percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer is the general partner in a partnership which owns a cable television business operating wholly within Indiana. Taxpayer has no other business activity than owning the partnership interest. As the result of an audit, the Indiana Department of Revenue ("Department") issued proposed assessments for gross income tax. The assessments were partially based on the Department's adjustment to include taxpayer's distributive share of partnership income as reported on taxpayer's Federal returns. Taxpayer protests the adjustment. Further facts will be supplied as necessary.

DISCUSSION

I. Gross Income Tax—Partner's Distributive Share

Taxpayer protests the proposed assessments for the tax years in question. The Department adjusted taxpayer's Indiana income to include taxpayer's distributive share of partnership income as taxpayer reported on its Federal returns. Taxpayer had deducted contributions to the partnership from taxpayer's distributive share of partnership income. Taxpayer refers to 45 IAC 1.1-2-13, which states:

- (a) As used in this section, “partner’s distributive share” means the amount determined under Section 704 of the Internal Revenue Code and its prescribed regulations before any modifications required by Indiana tax statutes.
- (b) An amount credited to a corporate partner as its distributive share of partnership income, which is derived from sources within Indiana is subject to the gross income tax. An amount previously subjected to the gross income tax because it was included in the partner’s distributive share but not actually distributed is not subject to the gross income tax again when it is distributed.
- (c) For purposes of this subsection, all income of the partnership shall be considered business income. If a partnership does business in a state besides Indiana, a partner’s distributive share of partnership income which is derived from sources within Indiana, for gross income tax purposes, shall be determined by multiplying the partner’s distributive share by a fraction. The numerator of the fraction shall be the sum of:
 - (1) the property factor;
 - (2) the payroll factor; and
 - (3) the sales factor;of the partnership. The denominator of the fraction shall be determined by the number of factors used. The property factor shall be determined under IC 6-3-2-2(c). The payroll factor shall be determined under IC 6-3-2-2(d). The sales factor shall be determined under IC 6-3-2-2(e) and IC 6-3-2-2(f).
- (d) The amount credited to a corporate partner as its distributive share of partnership income which is derived from sources in Indiana is taxable at the high rate.

Also, taxpayer refers to 45 IAC 1.1-1-5, which states:

- (a) “Constructive receipt” means an item of gross income which is not actually received by a taxpayer but is:
 - (1) credited to taxpayer;
 - (2) made available for the taxpayer’s withdrawal;
 - (3) paid to another for the taxpayer’s direct benefit; or
 - (4) income to which the taxpayer is entitled.
- (b) The term includes, but is not limited to, the following:
 - (1) The partial or complete forgiveness of a debt.
 - (2) Payment of a taxpayer’s obligations by a third party for the taxpayer’s direct benefit. The assumption of an outstanding lien on equipment sold by the taxpayer is not a payment for the taxpayer’s direct benefit.
 - (3) The sale, by a lender, of property pledged or assigned by the taxpayer as collateral for a loan.
 - (4) Amounts credited to a partner as its distributive share of partnership income.
 - (5) The amount of known liabilities discharged as a result of a sale or other disposition of property, and from which the taxpayer receives a direct benefit. For example, if a taxpayer sells a piece of equipment for five hundred thousand dollars, (\$500,000) and uses part of the proceeds to pay off a two hundred thousand (\$200,000) lien against the

pieces of equipment, the amount received by the taxpayer for gross income tax purposes is five hundred thousand dollars (\$500,000).

Next, taxpayer states that the Department must, under 45 IAC 1.1-2-13(a), follow Section 704 of the Internal Revenue Code (IRC) to determine the amount of the “partner’s distributive share” at issue. Taxpayer refers to IRC subsection 704(d), which states:

A partner’s distributive share of partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner’s interest in a partnership at the end of the partnership year in which such loss occurred. Any excess of such loss over such basis shall be allowed as a deduction at the end of the partnership year in which such excess is repaid to the partnership.

Taxpayer states that this subsection allows for the deduction of losses from previous years against the corporate partner’s current distributive share of partnership income, as a carryforward of the loss. That is not what IRC 704(d) provides. IRC 704(d) allows a partner to claim partnership loss and limits the amount of loss which is allowed to be claimed. As the Department explained in its audit report, taxpayer deducted contributions it made to the partnership from its distributive share of partnership income. Taxpayer did not claim partnership losses, which is the focus of IRC 704(d), therefore IRC 704(d) does not support taxpayer’s position.

Taxpayer also states that under relevant partnership concepts, an allocation has economic effect only if it affects the amounts the partners will receive over the life of the partnership, and that this is tracked through the partner’s capital account. Taxpayer argues that where a negative capital balance exists for one or more partners to a partnership, the income tax concepts embodied in partnership tax law do not evidence a constructive receipt of gross income. Taxpayer fails to cite any Indiana or Federal statute, regulation or case to support this argument.

In conclusion, 45 IAC 1.1-2-13(a) establishes that “partner’s distributive share” means the amount determined under Section 704 of the Internal Revenue Code and its prescribed regulations before any modifications required by Indiana tax statutes. 45 IAC 1.1-2-13(b) provides that an amount credited to a corporate partner as its distributive share of partnership income, which is derived from sources within Indiana is subject to the gross income tax. Since IRC 704(d) does not provide for the deduction of contributions, as claimed by taxpayer, the Department was correct to remove those deductions from taxpayer’s distributive share of partnership income.

FINDING

Taxpayer’s protest is denied.

II. Tax Administration—Negligence Penalty

The Department issued proposed assessments and the ten percent (10%) negligence penalty for the tax years in question. Taxpayer protests the imposition of penalty. The Department refers to IC 6-8.1-10-2.1(a), which states in relevant part:

If a person:

...

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

...

the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to reach and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

45 IAC 15-11-2(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC 6-8.1-10-2.1(a). In its protest letter, taxpayer states that it timely filed and timely paid all tax liabilities. Since the Department issued assessments for unpaid tax, and taxpayer paid the assessments except for the penalties, it stands to reason that taxpayer did not timely pay all tax liabilities. Taxpayer has not affirmatively established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c).

FINDING

Taxpayer's protest is denied.